Financial Inclusion: Issues and Challenges

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Abstract -- **A vast segment of India's population exists on the margins of India's financial systems. There is growing concern about people being 'under-banked'. Financial inclusion is important priority of the country in terms of economic growth and development of society. It enables to reduce the gap between rich and poor. It helps to channelize money-flow to the economy; it ensures people who are unable to access financial system so far can access it with ease. The paper discusses the role of financial inclusion in the economy and how the different stakeholders play an important role in developing the whole initiative.**

Keywords: Money-flow in Economy, Banking System, Financial Education, Access to Financial Services.

I. INTRODUCTION

FINANCIAL inclusion enhances the economy. In the contemporary era of running for economic power and self reliance, it is imperative for any regime to create congenial conditions for individuals, households and private institutions which included the availability of Banking services.. The availability of banking facilities and strong bank branch network are the major facilitator's of developmental and expansionary activities. A strong and sturdy financial system is a pillar of economic growth, development and progress of an economy[1]. A financial system, which is inherently strong, functionally diverse and displays efficiency and flexibility, is critical to our national objectives of creating a market-driven, productive and competitive economy[2] A mature system supports higher levels of investment and promotes growth in the economy with its coverage. The economic agents facilitate in growth and one of the important facilitator is Financial Inclusion .Financial inclusion is defined as delivery of financial services to the poor at affordable cost. As per V Leeladhar [6], financial inclusion means delivery of banking services at an affordable cost to the vast section of disadvantaged and low income groups [3] .

United Nations defined the main goals of inclusive finance as access to a range of financial services such s saving, credit, insurance, remittance, and other banking payment services to all bankable households and enterprise at a reasonable cost. The concept of financial inclusion can be traced back to the year 1904 when co-operative movement took place in India. It gained momentum in 1969 when 14 major commercial banks of the country were nationalized and lead bank scheme was introduced shortly thereafter. Branches were opened in large numbers across the country and even in the areas which were hitherto being neglected.

Even after all these measures a sizable portion of the population of the country could not be brought under the fold of banking system.(4) In fact, there is a severe gap in financial access which needs special attention.(5) Studies have proved that lack of inclusion or rather exclusion from the banking system results in a loss of 1% to the GDP(6). Thus, financial inclusion is not just a socio-political imperative but also an economic one. Realising the gravity of the problem, Reserve Bank of India in its Mid Term Review of Monetary Policy urged the banks to make financial inclusion as one of their prime objectives.

The positive impact of financial inclusion is wide-spread across the globe. Most of the literature on banking sector outreach focus on its effect through cross-country evidence. World Bank has also done a study on this subject for rural India and found that about 40% of households have deposit accounts, 20% have outstanding loans and only 15% have any insurance.

II. THE ESSENCE

Financial exclusion is broadly defined as the lack of access by certain segments of the society to suitable, low-cost, fair and safe financial products and services from mainstream providers. Thus the essence of financial inclusion is to ensure that a range of appropriate financial services is available to every individual and enable them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, insurance (life and non-life), etc.

The main reasons for financial exclusion, from the demand side are lack of awareness, low income, poverty and illiteracy; and from the supply side is distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes, etc. Due to all these procedural hassles people feel it easier to take money from informal credit sources, but it results in compromised standard of living, higher costs, and increased exposure to unethical and unregulated providers and vulnerability to uninsured risks. Thus financial inclusion does not mean merely opening of saving bank account but signifies creation of awareness about the financial products, education and advice on money management and offering debt counselling etc. by banks. Every society should ensure easy access to public goods. Therefore, banking service being a public good should also be aimed at providing service to the entire population.

Broadly, we can say that financial inclusion is a process of providing banking services to the poor at affordable cost, which improves their life.

III. THE IMPORTANCE

This can be answered by the given fact that if poor are not connected to our formal financial system, their growth and improvement will not take place and as the country grows they will still be poor without access to basic necessities. Secondly due to lack of financial system awareness they can be lured to enter in fraud money saving schemes and can be looted. They lack awareness of investing and will risk the future of their children. That is the reason why financial inclusion is important for any country for its growth.

As per the Rangarajan Committee report (2008) Financial Inclusion is defined "as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost". Broadly speaking, Financial Inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy.

The goals of financial inclusion can be met largely by initiative of banking sector to cut across various strata of society, regions, gender and income and encourage the public to embrace banking habit. Also, Reserve Bank of India, as the chief regulator has intervened for the success of financial inclusion by various enactments, financial literacy drives, leveraging technology etc.

Importance of financial inclusion can be summarised as below: If customer is financially educated, he will make better financial choices, for example what kind of financial products can fulfil his individual needs? It will help in improving overall growth of the country. Access to financial services at an affordable cost will improve life of the poor.

Financial inclusion is a long term strategy, but to achieve its objectives we need to keep in mind what are the key areas it should address:

- It should provide access to basic financial services like banking etc.
- The usage of financial services should address needs of the poor.
- The financial product should be affordable.
- Quality of product and services must be enhanced.

Recent development has shown that technology plays an important role in improving financial inclusion because of the following reasons:

- It helps to reduce cost of the product.
- Reduces transaction cost.
- Improves quality of the product.
- Helps in increasing choices and flexibility to customer.

All of the above reasons contribute in increasing the utility of the financial product.

IV. INTERNATIONAL EXPERIENCE

Financial Inclusion is considered to be the core objective of many developing nations since from last decade as many research findings correlate the direct link between the financial exclusion and the poverty prevailing in developing nations. According to World Bank report "Financial inclusion, or broad access to financial services, is defined as an absence of price or non price barriers in the use of financial services." The term Financial Inclusion needs to be interpreted in a relative dimension. Depending on the stage of development, the degree of Financial Inclusion differs among countries. India ranks second in the world in terms of financially excluded households after china. For the inclusive growth process of economy the central bank has also provided high importance to the financial inclusion.

The weaker sections of the society are generally ignored by the formal financial institutions in the race of making huge profits. Further there are the complexities involved in providing finance to the weaker section. Financial inclusion or inclusive financing is the delivery of financial services, at affordable costs, to sections of disadvantaged and low income segments of society.

There have been many formidable challenges in financial inclusion area such as bringing the gap between the sections of society that are financially excluded within the ambit of the formal financial systems in providing financial literacy and strengthening credit delivery mechanisms so as to improve the financial economic growth. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. It is argued that as banking services are in the nature of public good; the availability of banking and payment services to the entire population without discrimination is the prime objective of this public policy. Thus the term Financial Inclusion can be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost

India has a historic and well-structured banking system to cater to the financial needs of individuals and households and contribute towards the improvement and advancement of the nation. Towards these needs, necessary reforms, supervision and continuous monitoring are envisaged to ensure a modern and up-to-date banking practices, healthy competition, financial inclusion and well calibrated de-regulation. The Indian banking sector consists of the Reserve Bank of India which is the central bank, commercial banks and co-operative banks. Bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The rationale for creating Regional Rural Banks was also to take the banking services to poor people.

The banking industry has shown tremendous growth in volume and complexity over the last decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that much needed banking services have not reached a vast segment of the population, especially the underprivileged sections of the society. Internationally, also efforts are being made to study the causes of financial exclusion and designing strategies to ensure financial inclusion of the poor and disadvantaged. The reasons may vary from country to country and hence the strategy could also vary but all out efforts are being made as financial inclusion can truly lift the financial condition and standards of life of the poor and the disadvantaged.

V. RECENT TECHNOLOGICAL INNOVATION IN FINANCIAL INCLUSION

Technology plays an important part in improving the financial inclusion efforts. Mobile technology and its large scale penetration is a fine example. The first product which is popular worldwide is M-Pesa. M-Pesa of Kenya has spread so quickly and has become one of the most successful mobile based financial service. In 2007 on an average number of registration to M-Pesa in Kenya exceeded 5000 per day, by2009 around 7.9 million M-Pesa accounts are registered.

Customers in Kenya started using M-Pesa for their day to day activities, as there was no hard currency involved there was less risk of theft. Due to increase in M-Pesa outlets demand for banking agents increased, which ultimately increased job opportunity in the country. M-pesa is a simple mobile banking application in which customer can send money to any individual or can purchase items by doing transaction with M-Pesa application.

One of the main reasons for M-Pesa growth in Kenya is due to increase in growth of mobile communication in late 2000's. Secondly, the product was simple to use and affordable for the locals. It provided choices of product which customer can choose. It facilitated easy cash convertibility due to availability large number of M-Pesa outlets. Regulators encouraged mobile financial services across the world. After success of M-Pesa many countries adapted the idea of branchless banking. As per current trend the future of branchless banking looks bright. A lot of technological innovation will be coming in future to boost financial inclusion. To support these initiatives, apart from government , there are some international agencies which also works for financial inclusion, namely World Bank, CGAP, Bill and Malinda Gates Foundation.

After the M-Pesa, many companies in Kenya are investing in branchless banking, recently there are new products have been launched which are similar to M-pesa like IKO–Pesa also known as orange money.Other countries have also developed mobile banking solutions with the help of service providers and banks. Below is the list to name a few

- Easy Paisa-Pakistan
- EKO in India
- G-Cash in Philippines.

A strong technological innovation in financial services needs to be supported by strong business model. In case of M-pesa it was backed by strong agent network which gave customer easy availability to customer support, cash conversion, and better quality of service. Also the support of safari.com the largest telecom operator in Kenya provided them better edge due to large customer base and highly reliable brand name.

VI. ROLE OF BASIC FINANCIAL EDUCATION

A deep analysis of the trend in mobile banking can easily make us understand that, having better technology and better product itself is not enough. The customer should have basic financial education as well as usage of technology (Imagine a scenario that if the customer don't know how to operate a mobile phone, will he be interested to go for mobile banking). So basic education of financial services is important .The customer should know why, long term investments are important for their family. How can we ensure that basic needs of poor are provided which includes access to services, better financial education. This is where role of regulator comes in picture.

Several empirical analysis indicate a negative influence of population density on deposit penetration. The finding implies that although deposit accounts have improved over time, but its growth has not matched with respect to the population increase. But, the relationship is not as clear in case of credit penetration as the coefficient is insignificant. The average population per branch is having a negative influence on deposit penetration. It confirms the beneficial impact of improvement of branch network on financial inclusion drive, which occurs due to greater accessibility and convenience.

The income level is unambiguously having a positive influence on both penetration proportions. It points to the fact that level of economic condition is a vital determinant of financial inclusion efforts. The outcome corroborates the phenomenon of higher usage and requirement for financial services with increase in the standard of living. Both proportion of factories and employees to population are having a significant and positive influence on deposit penetration. It implies that region's structural and environmental setup has a role in determining the deposit penetration.

A positive coefficient for the employee proportion indicates that employed people seem to be more active, aware, interested with regard to banking activities related to both credit and deposit activities. Using test for convergence it is found that the states tend to maintain their respective level of banking activity vis-à-vis the rest. This has an important implication for the regions performing low in terms financial inclusion. It seems that due to certain inherent structural characteristics low performing states are unable to close the gap.

VII. IMPACT OF REGULATION

Regulation defines the business rules of a country. In case of branchless banking, regulation can play key role in enhancing customer satisfaction, ensuring proper service given to end users, to create an environment which should be a win-win situation for both business entities and customer.

Below are some basic observations on regulation in branchless banking implemented around the world:

- Regulators should be open to experiment, learn and implement.
- They should work on enhancing public-private partnership.
- Relaxed KYC requirements for smooth customer sign-up.
- Focus on customer security and protection.

A vast segment of India's population exists on the margins of India's financial systems. Whilst the per-capita savings of this class may not be very high their sheer number means that taken together their savings are of a considerable amount. If their entry in the formal financial sector is made easier these savings can be channelized for an inclusive growth with a distributive justice. Also savings cum risk products that are their primary need can be structured for them once they are part of the formal banking system.

Among the developed nations, UK was one of the earliest to realize the importance of financial inclusion. Around 8 per cent of the households lacked any kind of deposit account. Account holding is lowest for people aged under 20 and over 80 years. Reasons for exclusion vary from low credit scoring, legislation to prevent bank accounts for 'money laundering', mistrust by people , terms and condition of the banks, physical access problems among others. In Australia, the prevalence of un-banked adults is much lower than in other developed nations, with estimates of just 3% of adults lacking a bank account. There is however growing concern about people being ‘under-banked’.

Financial inclusion is not a short term goal: it is a big initiative and will itself evolve as the time progresses. The stake holders who are involved are government, regulators, public and private entity and the People of the country. To enhance financial inclusion initiative all stockholders have to work together to create a better business model which not only serves the need of the current economy but also it should build foundation for future financial inclusion plans .In this regards it is worth to mention that the technology plays a vital role. It helps to reduce transaction cost, enhances customer accessibility, products are more affordable.

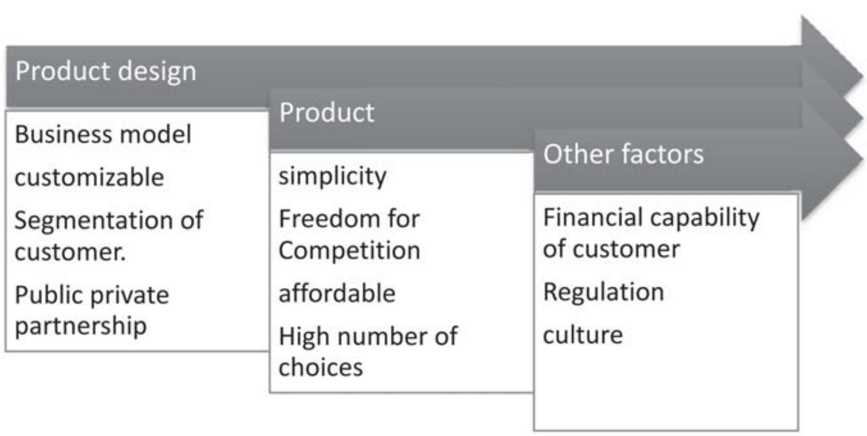

Figure 1. Product ecosystem.

Access to financial services for people, especially poor and deprived, is critical. Also, access to finance by micro-entrepreneurs is imperative for inclusive and overall growth of the economy. The Indian legislature has been conscious of this fact since early. Bank nationalization in India gave the first vigorous focus of banking to mass banking. The rationale for creating Regional Rural Banks was also to take the banking services to poor people. The branches of commercial banks and the RRBs have increased from 8321 in the year 1969 to 84,504 branches as at the end of March 2010. The average population per branch office has decreased from around 64,000 to less than 14,000 during the same period.

The number of 'No frill' accounts has also registered a growth over the last few years. In view of their vast branch network, public sector banks and the regional rural banks have been able to scale up their efforts by merely leveraging on the existing capacity. However, there are still many areas under-banked, particularly in Bihar, Orissa, Rajasthan, Uttar Pradesh, West Bengal and a large number of North-Eastern states, where the average population per branch office continues to be quite high compared to the national average. In this respect, the new branch authorization policy of Reserve Bank of India encourages banks to open branches in the under banked regions. The new policy also places a lot of emphasis on the efforts made by RBI to achieve, inter alia, financial inclusion and other policy objectives.

To measure financial inclusion, a multidimensional Index of Financial Inclusion (IFI) has been proposed. The IFI is an index that captures information on various dimensions of financial inclusion in one single digit lying between 0 and 1. It captures the penetration of the banking system, its availability to users and its actual usage. Axiomatic measurement approach is employed for the measurement of financial inclusion. It improves upon the IFI proposed such that the index can be utilized to determine the percentage contributions by the various factors.

Standing out on a global platform India has to look upon the progress in inclusive growth and financial inclusion is the key for inclusive growth. There is a long way to go for the financial inclusion to reach to the core poor. According to K.C. Chakrabarty RBI Deputy Governor "Even today the fact remains that nearly half of the Indian population doesn't have access to formal financial services and are largely dependent on money lenders". Mere opening of no-frill bank accounts is not the purpose or the end of financial inclusion while formal financial institutions must gain the trust and goodwill of the poor through developing strong linkages with community-based financial ventures and cooperative. Financial Inclusion has not yielded the desired results and there is long road ahead but no doubt it is playing a significant role and is working on the positive side.

The issue of financial inclusion has received large importance in India during the recent years. India had invested considerable amount of resources in expanding its banking network with the objective of reaching to the people. During the last 40 years huge infrastructure has been created in the banking sector. However, this large infrastructure that has penetrated even remote rural areas has been able to serve only a small part of the potential customers. While India is on a very high growth path, almost at the two-digit level, majority of the people are out of the growth process. This is neither desirable nor sustainable for the nation. We also know that one of most important driving forces of growth is institutional finance. Therefore, it is now realised that unless all the people of the society are brought under the ambit of institutional finance, the benefit of high growth will not percolate down and by that process majority of the population will be deprived of the benefits of high growth. Thus financial inclusion is not only socio-political imperative but also an economic issue.

VIII. RECOMMENDATIONS

Financial inclusion is still a long road ahead. Innovations in the field of branchless banking and banking business model are making their way towards this goal. Recent exploration suggests that product plays a very important role in creating a financially inclusive ecosystem. If we observe the innovations happened around the world in financial inclusion, we can easily say that below factors are main criteria for making financial inclusion a success:

Following suggestions are to be implemented in India for enhancing the Financial Inclusion:

- Government should increase number of banks branches in remote areas.
- Banks should focus more on products which should be simple, affordable , and should have high utility.
- RBI should frequently check whether the financial products are actually utilized by customer effectively, if not it should analyse the reasons.
- Banks should do regular surveys in villages for understanding the financial needs of the people.
- NGOs and other not for profit organisation/ social organisations / Non Governmental organisations etc. may be involved more to propagate the financial services to the remote and non accessible areas.
- Banks should allow customers to provide feedback about the product services.
- R B I should allow service providers to provide better mobile banking products at affordable price.
- Micro Finance Organisations/ Non Banking Financial organisations may be given permissions to do limited financial services in remote areas.
- Enlist many intermediaries/ agents with incentives to facilitate popularising Financial products in remote areas.
- Opening of Bank Accounts without minimum balance condition should be allowed at all branches and places.

Also simplify the procedure of opening the bank account. No introduction/security to be insisted.

- Opening Bank Branches in remote and rural areas should be liberalised by RBI.
- Institutionalise the agency system that can bring the bank services at the door step of customer on a commission basis like commission agents/ daily collectors etc. authorised by Banks.
- Telecom Service providers and Banks should together workout and implement Mobile Banking simple solutions.
- RBI should allow entrepreneurs to invest in new product innovation in financial innovation.
- Mobile Banking should be encouraged/incentivised as a smart way of sending and depositing money in Rural areas.
- There should be special discounted charges for Banking services in Rural areas like Telephone calls originating in Rural Telephones. For example the interest charges in Rural areas should be less than that of Urban .Similarly the saving Bank account in Rural can be given more interest than in Urban. The additional burden on account of this should be met from a separate fund like USO fund in Telecom.

Financial inclusion enhances the economy. It will grow faster and will be more stable. It will increase the quality of life of the people of the country and also ensure an orderly growth. It will also reduce the gap between the rich and the poor. This is what Mahatma Gandhi visualised our India should be.

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